

MERCER

Human Resource Consulting

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Public Employee Post-Employment Benefits Commission State of California

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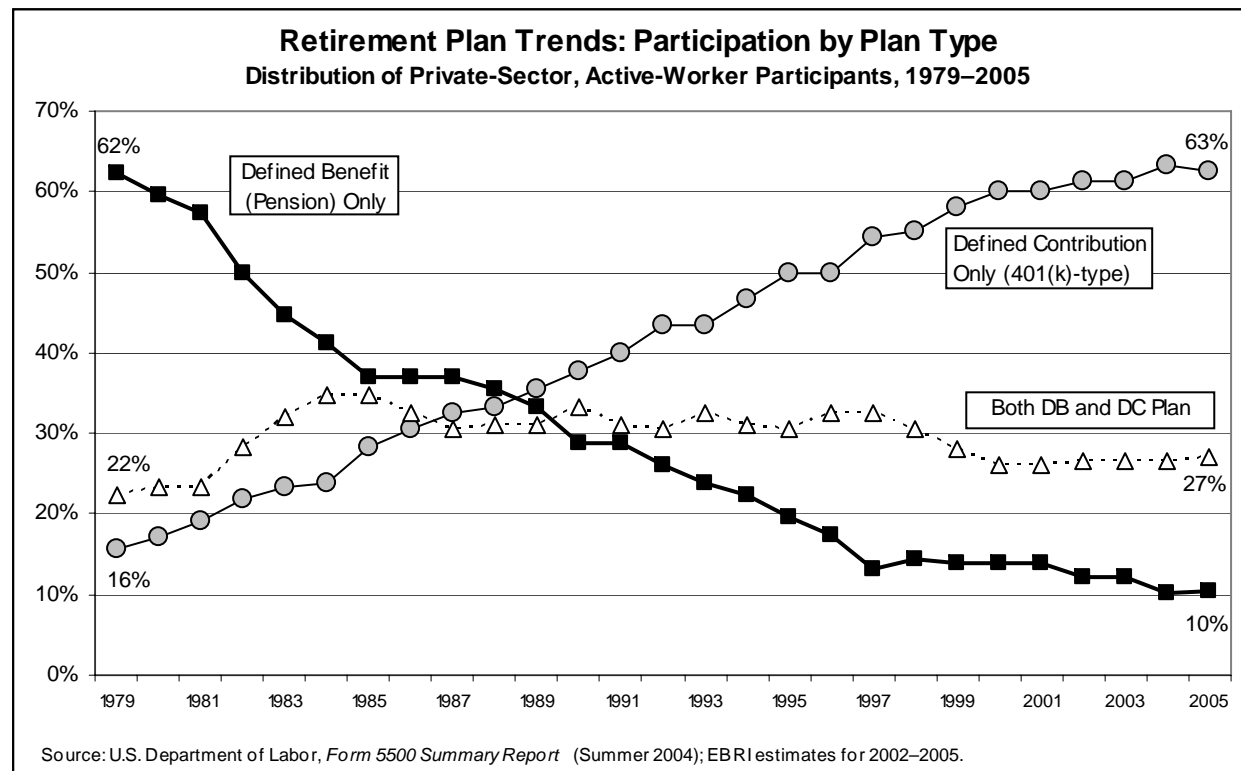
Private Sector Pension Experience

Financial needs in retirement are increasing

- Longevity continues to increase
- Medical expenses rise, particularly for elderly
- However, the amount and diversity of retirees financial resources is declining

Private Sector Retirement Coverage

Percent of Workers by Plan Type



In the private sector, participation by type of retirement plan has largely reversed over the past quarter-century: "Traditional" defined benefit pension plans were dominant in 1979, but have been overtaken by defined contribution (401(k)-type) plans. The share of workers who are in *both* a defined benefit and defined contribution plan has remained fairly constant over the years.



Private Sector Pension Experience

Shortcomings of Individual Account Plans as Sole Retirement Vehicle

- Voluntary coverage
- Investment returns vary by individual
- Investment returns are generally lower
- Leakage
- Market cycles affect retirement timing
- Little or no risk pooling



Private Sector Pension Experience

Pension plans offset the shortcomings of individual account plans

- Universal coverage
- Benefits unaffected by individual investment decisions
- Investment returns are generally higher
- Little or no leakage
- Market cycles do not affect retirement benefits
- Longevity pooling allows funding for average life expectancy, producing significant efficiencies



Private Sector Pension Experience

Pension plans coverage has declined for multiple reasons

- Change from liberal to strict funding standards
- Change from flexible, even lax, accounting to mark to market accounting
- Movement toward greater transparency of financial reporting
- Pension plans inherently involve estimates and uncertainty
- Individual account plans are highly transparent, no estimates
- Higher **sponsor** expense level for pension plans
 - Expenses of pension plan are borne entirely by sponsor, while expenses of DC plan can be passed to participant
 - PBGC expenses



Private Sector Pension Experience

Efficiencies of pension plans are available in other models, but not all permissible under current US law

- Benefits and contributions can be adjusted as funding ratios change
 - Sponsor and participant share in adjustments
 - Provides relative cost stability or limits to volatility
 - Participant receives lifetime income although amount may change
- Variable annuity plans
 - Investment risk and reward transferred to participant
 - Longevity risk retained by sponsor and pooled
 - Investments can be directed by participant or sponsor

These variations on current DB/DC model can produce greater cost stability and lifetime income



Private Sector Pension Experience

Summary

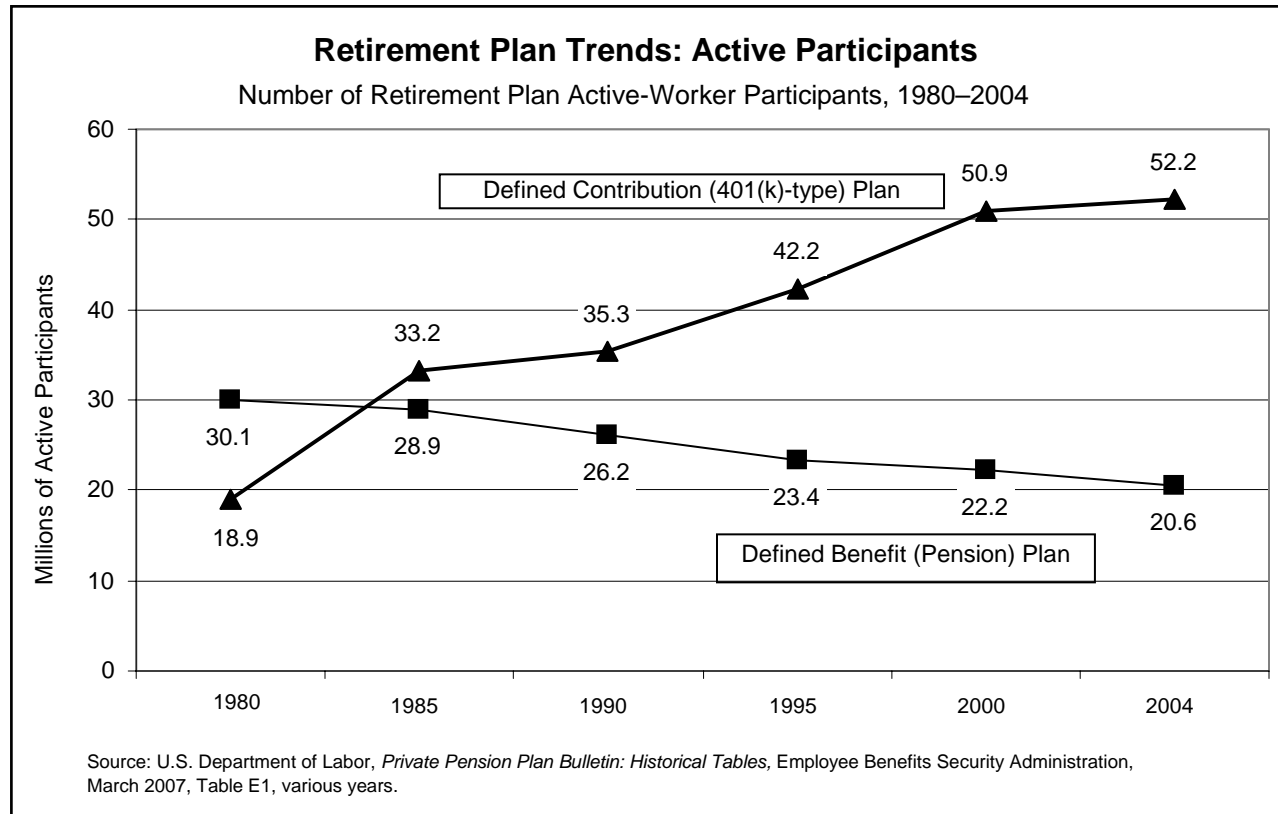
- Our workforce is aging and retirement issues will grow substantially in the near term
- A successful retirement model needs diverse sources of income – over reliance on any single element creates instability
- The three-leg stool analogy is at risk
 - DC plans transfer risk and responsibility to individual
- New designs that assure lifetime income and risk sharing should be evaluated and considered
- Restoring balance to the retirement system will enhance retirement security and can be done at the same time as increasing cost stability and intergenerational equity



Appendix Additional Charts from EBRI Report

Private Sector Retirement Coverage

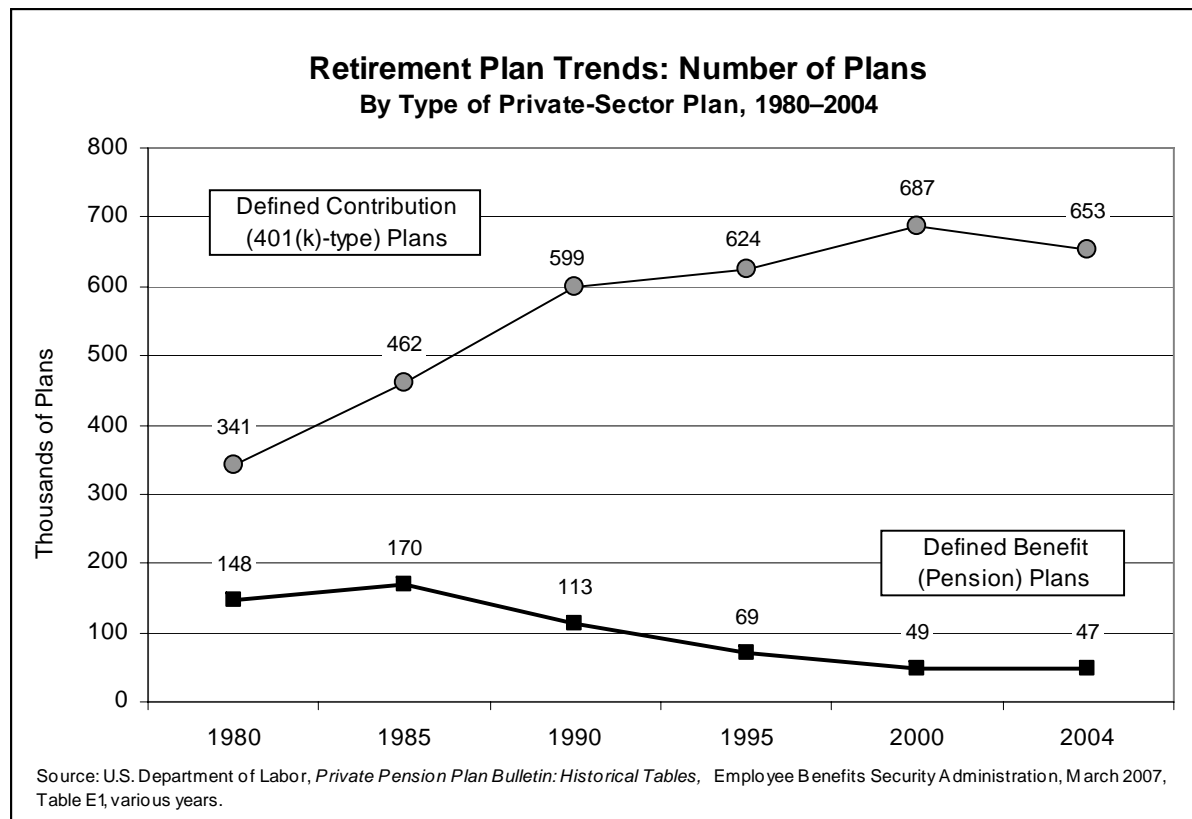
Number of Participants by Plan Type



The number of active workers participating in an employment-based defined benefit (pension) plan has been steadily decreasing, while the number has been growing in 401(k)-type plans.

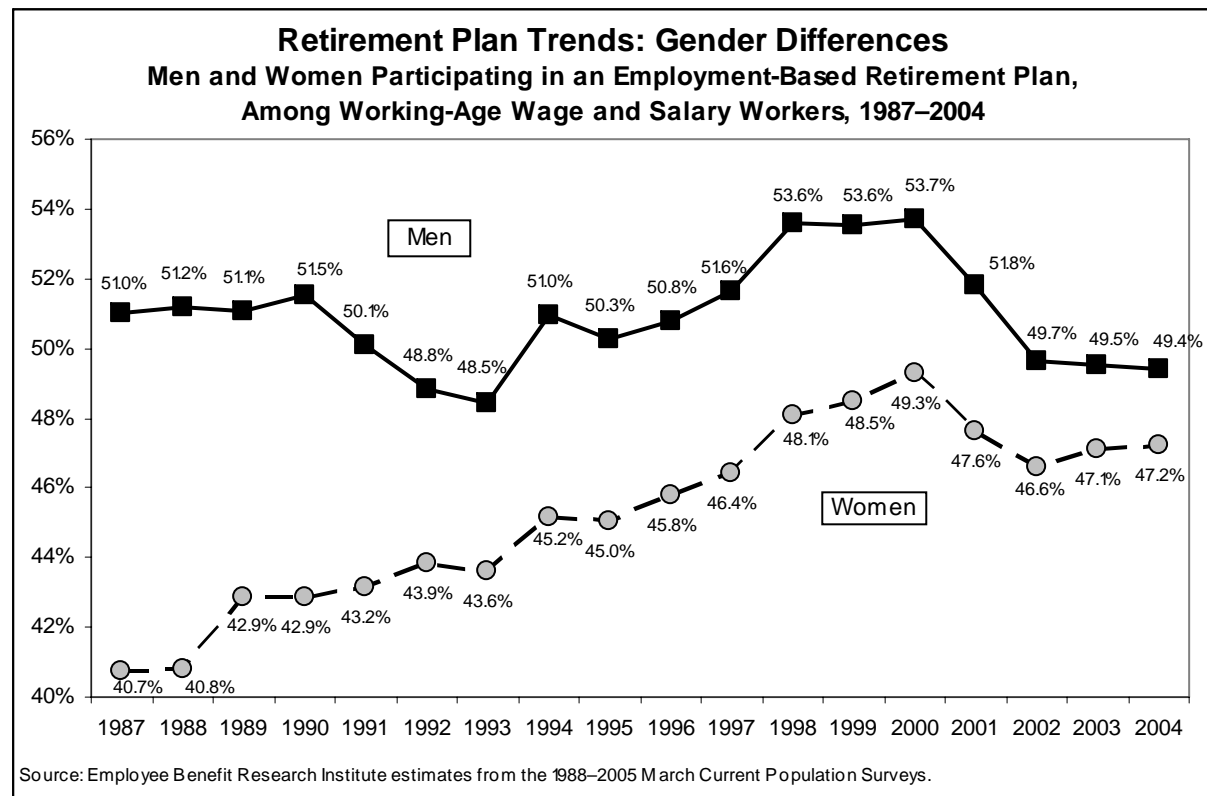
Private Sector Retirement Coverage

Number of Plans by Plan Type

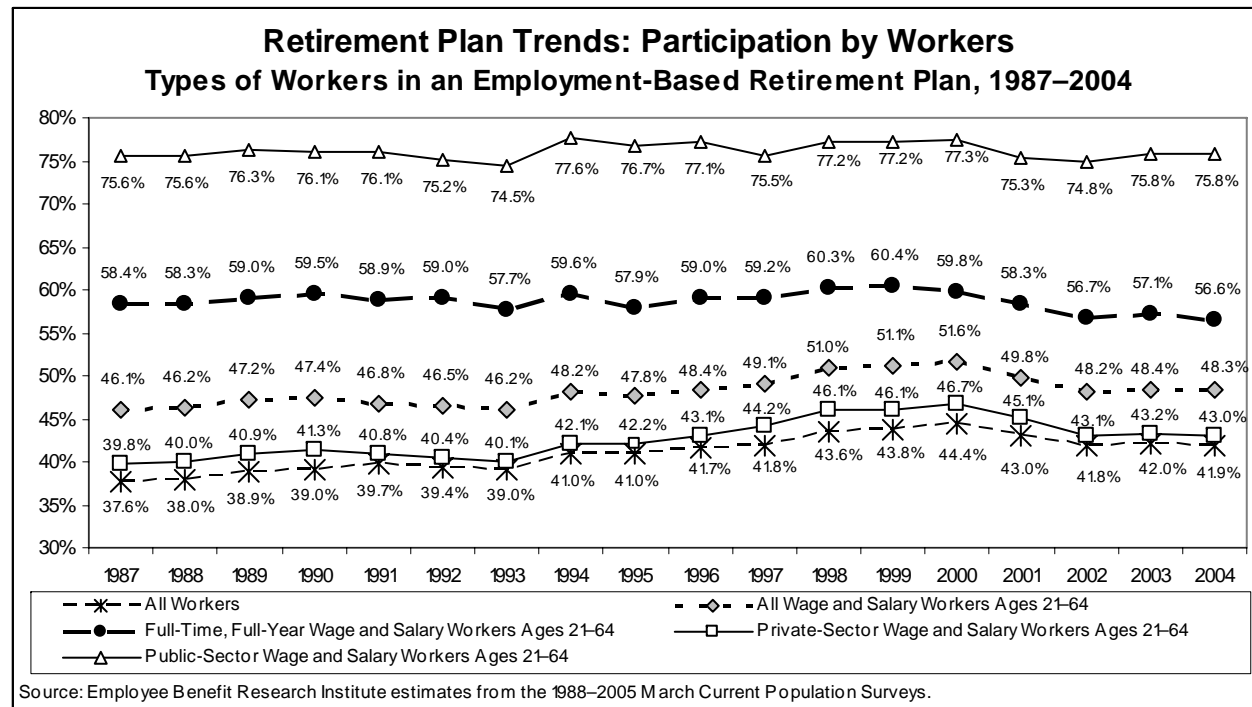


In the private sector, there are far more defined contribution (401(k)-type) plans than there are defined benefit (pension) plans; however, the average 401(k)-type plan has fewer participants than the average pension plan.

Private Sector Retirement Coverage Percent of Workers by Gender – All Plans



Private Sector Retirement Coverage Coverage by Types of Workers



Whether a worker is offered and participates in a retirement plan at work depends greatly on what type of worker the person is:

- *Public-sector workers* have the highest level of participation in a retirement plan (75.8% in 2004), while *part-time workers* typically are not offered a retirement plan or rarely participate when they are.
- Among *all workers*, less than half (41.9% in 2004) participate in a retirement plan.
- Among *full-time, full-year wage and salary workers*, more than half (56.6% in 2004) participate in a retirement plan.